RESEARCH PAPER | Management | Volume : 5 | Issue : 11 | November 2015 | ISSN - 2249-555X

Human Capital Development and Its Impact on Firm's Performance

KEYWORDS: Human capital, firm performance and workforce.

G.S.Srinivasmurthy

Asst. Professor, Dept of Management Studies, PSCMR College of Engineering & Technology, Vijayawada

M.Sridevi

Asst. Professor, Dept of Management Studies, Potti Sriramulu College of Engineering & Technology, Vijayawada

ABSTRACT *Human capital is getting wider attention with increasing globalization and also the saturation of the job market due to the recent downturn in the various economies of the world. Developed and developing countries put emphases on a more human capital development towards accelerating the economic growth by devoting necessary time and efforts. Thus human capital development is one of the fundamental solutions to enter the international arena. Specifically, firms must invest necessary resources in developing human capital which tend to have a great impact on performance. This paper examines the extent to which human capitals have direct impacts on firm performance from various critical perspectives. Firm performance is viewed in terms of financial and non-financial performance. Finally, this paper develops a model that explains the relationship between human capital and firm performance.*

Introduction

In current global market, companies are composed by competitors, regardless of industry. To develop a competitive advantage, it is important that firms truly leverage on the workforce as a competitive weapon. A strategy for improving workforce productivity to drive higher value for the firms has become an important focus. Firms seek to optimize their workforce through comprehensive human capital development programmes not only to achieve business goals but most important is for a long term survival and sustainability. To accomplish this undertaking, firms will need to invest resources to ensure that employees have the knowledge, skills, and competencies they need to work effectively in a rapidly changing and complex environment. In response to the changes, most firms have embraced the notion of human capital has a good competitive advantage that will enhance higher performance. Human capital development becomes a part of an overall effort to achieve cost-effective and firm performance. Hence, firms need to understand human capital that would enhance employee satisfaction and improve performance. Although there is a broad assumption that human capital has positive effects on firms' performance, the notion of performance for human capital remains largely untested. Hence, this paper attempts to look into the connection between human capital and firm's performance in the developmental economics. To what extent does human capital create impact on firm Performance While much of the argument in the literature in terms of factors contributing to performance, this paper looks at one of the factors i.e. human capital. Firm performance is a common issue in any organizations.

Definition of Human Capital and Firm Performance

What is human capital? According Schultz (1993), the term "human capital" has been defined as a key element in improving a firm assets and employees in order to increase productive as well as sustain competitive advantage. To sustain competitiveness in the organization human capital becomes an instrument used to increase productivity. Human capitals refer to processes that relate to training, education and other professional initiatives in order to increase the levels of knowledge, skills, abilities, values, and social assets of an employee which will lead to the employee's satisfaction and performance, and eventually on a firm performance. Rastogi (2000) stated that human capital is an important input for organizations especially for employees' continuous improvement mainly on knowledge, skills, and abilities. Thus, the definition of human capital is referred to as "the knowledge, skills, competencies, and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being" (Organization for Economic Co-Operation and Development or OECD, 2001: 18).

The constantly changing business environment requires firms to strive for superior competitive advantages via dynamic business plans which incorporate creativity and innovativeness. This is essentially important for their long term sustainability. Undoubtedly, human resource input plays a significant role in enhancing firms' competitiveness (Barney, 1995). At a glance, substantial studies were carried out on human capital and their implications on firm performance were widely covered and obviously, human capital enhancement will result in greater competitiveness and performance (Agarwala, 2003; Guthrie et al., 2002).

Human Capital Theory

The theory of human capital is rooted from the field of macroeconomic development theory (Schultz, 1993). Becker's (1993) classic book, Human Capital: A Theoretical and Empirical Analysis with special reference to education, illustrates this domain. Becker argues that there are different kinds of capitals that include schooling, a computer training course, expenditures on medical care. And in fact, lectures on the virtues of punctuality and honesty are capital too. In the true sense, they improve health, raise earnings, or add to a person's appreciation of literature over a lifetime. Consequently, it is fully in keeping with the concept as traditionally defined to say that expenditures on education, training, and medical care, etc., are investment in capital. These are not simply costs but investment with valuable returns that can be calculated. From the perspective of Classical Economic Theory, human capital considers labour as a commodity that can be traded in terms of purchase and sale. This classical theory very much focuses on

Volume : 5 | Issue : 11 | November 2015 | ISSN - 2249-555X

the exploitation of labour by capital. However, unlike the meaning traditionally associated with the term labour, human capital refers to the knowledge, expertise, and skill one accumulates through education and training. Emphasizing the social and economic importance of human capital theory, Becker (1993) noted the most valuable of all capital is that investment in human being. Becker distinguishes firm-specific human capitals from general-purpose human capital. Examples of firm-specific human capital include expertise obtained through education and training in management information systems, accounting procedures, or other expertise specific to a particular firm. General-purpose human capital is knowledge gained through education and training in areas of value to a variety of firms such as generic skills in human resource development. Regardless of the application, Becker considers education and training to be the most important investment in human capital.

The human capital focuses two main components which is individuals and organizations. This concept have further been described by Garavan et al., (2001) that human capitals have four key attributes as follows: (1) *flexibility and adaptability (2) enhancement of individual competencies (3) the development of organizational competencies and (4) individual employability*. It shows that these attributes in turn generate add values to individual and organizational outcomes. There are various findings that incorporate human capital with higher performance and sustainable competitive advantage (Noudhaug, 1998); higher organizational commitment (Iles et al., 1990); and enhanced organizational retention (Robertson et al., 1991).

Hence, all this debates fundamentally focuses on individual and organizational performance. From the individual level, Collis and Montgomery (1995) point out that the importance of human capital depends on the degree to which it contributes to the creation of a competitive advantage. From an economic point of view, transaction-costs indicate that firm gains a competitive advantage when they own firm-specific resources that cannot be copied by rivals. Thus, as the uniqueness of human capital increases, firm have incentives to invest resources into its management and the aim to reduce risks and capitalize on productive potentials. Hence, individuals need to enhance their competency skills in order to be competitive in their organizations.

The human capital theory has undergone a rapid development. Within its development, greater attention has been paid to training related aspects. This is much related to the individual perspective. Human capital investment is any activity which improves the quality (productivity) of the worker. Therefore, training is an important component of human capital investment. This refers to the knowledge and training required and undergone by a person that increases his or her capabilities in performing activities of economic values. Some recent literature shows the importance of training. In any case, it is fitting to point out that the workforce's lack of training is related to low competitiveness (Green, 1993). In turn, a greater human capital stock is associated with greater productivity and higher salaries (Mincer, 1997). Likewise, training is linked to the longevity of companies (Bates, 1990) and greater tendency to business and economic growth (Goetz and Hu, 1996). In addition, Doucouliagos (1997) has noted human capital as a source not only to motivate workers and boost up their commitment but also to create expenditure in R&D and eventually pave a way for the generation of new knowledge for the economy and society in general. Also, for small businesses it is a valuable asset, which is positively associated with business performance. Finally, investment in training is desirable form both a personal and social perspective.

From the organizational level, human capital plays an important role in the strategic planning on how to create competitive advantages. Following the work of Snell et al., (1999) it stated that a firm's human capital has two dimensions which are value and uniqueness. Firm indicates that resources are valuable when they allow improving effectiveness, capitalizing on opportunities and neutralizing threats. In the context of effective management, value focuses on increasing profits in comparison with the associated costs. In this sense, firm's human capital can add value if it contributes to lower costs, provide increased performances. Another study by Seleim, Ashour, and Bontis (2007) analyzed on the relationship between human capital and organizational performance of software companies. They found that the human capital indicators had a positive association on organizational performances. These indicators such as training attended and team-work practices, tended to result in superstar performers where more productivity could be translated to organizational performances. This was also supported by Dooley (2000) who found a significant positive correlation between the quality of developers and volume of market shares. Based on the above arguments we can conclude that human capital indicators enhanced the firm performance directly or indirectly. A study by Bontis and Fitzenz (2002) found that the consequences of human capital management and they established the relationship between human capital management and economic and business outcomes. In this study, a total of 25 firms in the financial services companies were selected measured human capital effectiveness with four metrics; revenue factor, expense factor, income factor and HC ROI. The fundamental aspects of any organization are to generate more revenue and income per employee. Human capital has a direct impact on the intellectual capital assets that will yield higher financial results per employee. The development of human capital is positively influenced by the educational level of employees and their overall satisfaction. Therefore, development human capital has a direct impact on ROI of firms.

Conceptual Model

The purpose of this paper is to show the relationship between human capital and firm performance. As argued in the earlier discussions, the general human capital investment includes training, education, knowledge and skills that will enhance human capital effectiveness. Based on the literature reviews, it is therefore postulated that human capital leads to greater firm performance. Firm performance can be viewed in two different perspectives; financial performance and non-financial performance. Financial performance includes productivity, market share and profitability, whereas, non-financial performance includes customer satisfaction, innovation, workflow improvement and skills development.

Conclusion

This paper explored the current literature on human capital and its impact on firm performance. The conceptualization of human capitals is closely linked to some fundamentals of economics and firm performance. The literature reviews show that there are reasonably strong evidences to show that the infusion of 'human capital enhancement' in organizations promotes innovativeness and greater firm

Volume : 5 | Issue : 11 | November 2015 | ISSN - 2249-555X

performance. Studies also clearly substantiate the fact that financial performance is positively impacted through the consideration of human capitals. In light of this, the understanding of firm performance in relation to human capitals should not be regarded as a phenomenon that only adds 'more zeros' in a firm's profits; it is rather transforming the entire workforce as the most 'valuable assets' in order for the organization to pave ways for greater achievements via innovativeness and creativity. Hence, companies should therefore, come up with some effective plans especially in investing the various aspects of human capital as not only does it direct firms to attain greater performance but also it ensures firms to remain competitive for their long term survival.

REFERENCE 1. Agarwala, T. (2003). Innovative human resource practices and organizational commitment: An empirical investigation. 2. International Journal of Human Resource Management, 14(2), 175–197. 3. Bantel, K. (1993). Strategic clarity in banking: Role of top management-team demography. Psychology Reports, 73, 1187-1203. 4. Becker, G.S. (1993). Human Capital: A Theoretical and Empirical Analysis with Special Reference to Education (3rded.).Chicago: University of Chicago Press. 5.Bontis, N. & Fitzenz, J. (2002). Intellectual capital ROI: A current map to human capital antecedents and consequences.